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Public Utility Commission of Texas

Commissioner Memorandum

TO: Commissioner Will McAdams
Commissioner Lori Cobos
Commissioner Jimmy Glotfelty

FROM: Chairman Peter M. Lake

DATE: November 17, 2021

RE: November 18, 2021 Open Meeting – Item No. 3; Docket No. 51415; SOAH Docket No. 473-21-0538 – Application of Southwestern Electric Power Company for Authority to Change Rates

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This case presents a number of unique issues for our consideration, and my intention in this memo is to organize my thoughts in a way that helps facilitate our discussion at the open meeting. At the outset, I want to commend the ALJs who prepared the proposal for decision (PFD) because it presents a thorough and coherent analysis of the issues. The good work at SOAH certainly makes our job easier now that the case has returned to the Commission for a final decision.

Owing to the ALJs' cogent recommendations, I would adopt the majority of the PFD. However, I would deviate from the PFD on the following issues for the reasons stated below.

1. Self-Insurance Reserve (PFD at p. 95)

SWEPCO requests the establishment of a self-insurance reserve to cover potential liability or catastrophic property loss that could not have been reasonably anticipated and included under operating and maintenance expenses. The PFD recommends denial of the self-insurance reserve on the grounds that it is not supported by a cost-benefit analysis.

I would reject the PFD on this issue because SWEPCO presented adequate testimony of cost savings attributable to the self-insurance plan. While SWEPCO did not quantify the precise savings associated with its self-insurance proposal, it did offer a detailed assessment of the numerous expenses that SWEPCO would avoid through self-insurance. These avoided expenses should constitute a sufficient consideration of costs to satisfy Commission rules regarding self-insurance. Moreover, the Commission previously approved a self-insurance plan similar to SWEPCO's plan in AEP Texas's most recent rate case.[1] Accordingly, I would approve SWEPCO's self-insurance reserve plan.

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[1] *See Application of AEP Texas Inc. for Authority to Change Rates*, PUC Docket 49494, Order (Apr. 3, 2020).

2. Hurricane Laura Costs (PFD at p. 101)

SWEPCO requests authorization to charge its Texas jurisdictional Hurricane Laura restoration costs against the self-insurance reserve addressed above. No party opposed this proposal, aside from challenging the self-insurance reserve itself. Because I would approve of the self-insurance reserve, I would also approve of charging Hurricane Laura costs against that reserve.

3. Return on Equity (PFD at p. 101)

The PFD recommends a return on equity (ROE) of 9.45%, but this strikes me as a bit high for several reasons. First, PURA gives the Commission the authority to consider the quality of a utility's services when establishing a reasonable return.[2] The outage event on SWEPCO's system in August of 2019 is indicative of periodically unreliable service quality. Although SWEPCO has increased its vegetation management expenses and invested in infrastructure replacement projects, system reliability has not appreciably improved. In fact, SWEPCO's SAIDI and SAIFI scores have worsened since 2018.[3]

In addition, prevailing market conditions weigh in favor of a lower ROE. Thirty-year treasury yields and AAA-rated corporate bond yields are more than 100 basis points lower than they were at the time of SWEPCO's last rate case in 2017. Both short- and long-term interest rates have declined since 2017, meaning that utilities enjoy favorable access to capital financing. Finally, electric utility ROEs have steadily decreased since 2017, as noted in TIEC's exceptions.[4]

With these considerations in mind, I would approve a slightly lower ROE of 9.3%. This rate is at the higher end of Commission Staff and TIEC's suggested ROE, but more importantly, it reflects SWEPCO's performance record as well as current market conditions with respect to electric utilities.

4. Vegetation Management Consultant (PFD at p. 139)

In light of SWEPCO's service quality record and vegetation management deficiencies, Commission Staff recommends that SWEPCO be required to hire a consultant to conduct a comprehensive review of the transmission system and make recommendations to protect that system. There is precedent for requiring a utility to hire this type of consultant, but I am not entirely convinced that a mandated, ratepayer-funded consultant is appropriate in this case.

Even so, I do think it would be prudent for the Commission to order SWEPCO to provide additional information regarding vegetation management as it relates to system performance. Accordingly, I would require SWEPCO to file the following information in its annual report every year: (1) each occurrence of an outage related to vegetation contact with utility infrastructure and (2) a listing of every distribution line that has not received vegetation management treatment in the previous four years.

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[2] Tex. Util. Code § 36.052.

[3] Commission Staff Ex. 56, SWEPCO's response to CARD RFI 9-20; Tr. At 535.

[4] TIEC Exceptions to the PFD at 7 (Fig. 1).

5. Financial Integrity and Ring-Fencing (PFD at p. 149)

SWEPCO is just one of many AEP subsidiaries. AEP and its various subsidiaries engage in a range of activities related to electricity production, delivery, and service across the country.[5] Recognizing that the financial instability of an affiliate entity could impact SWEPCO, the ALJs recommended ring-fencing protections to insulate SWEPCO from its parent and the affiliated companies. I support those mechanisms, so after reviewing the record and parties' briefing, I would also adopt two more ring-fencing provisions recommended by Commission Staff.

a. No Cross-Default Provisions

A cross-default provision that has the potential to imperil SWEPCO's assets or creditworthiness may benefit an affiliate entity, but it does not benefit SWEPCO's Texas ratepayers. Accordingly, I would add a ring fence provision along the following lines: "SWEPCO's credit agreements and indentures will not contain cross default provisions whereby a default by AEP or its other affiliates would cause a default by SWEPCO."

b. No Financial Covenants or Rating Agency Triggers Related to Another Entity

Similar to the cross-default issue, a prohibition of financial covenants and rating agency triggers in SWEPCO's debt or credit agreements will insulate Texas ratepayers from business risks that do not provide a ratepayer benefit. For this reason, I would add a provision along the following lines: "The financial covenant in SWEPCO's credit agreements will not be related to any entity other than SWEPCO. SWEPCO will not include in its debt or credit agreements any financial covenants or rating agency triggers related to any entity other than SWEPCO."

6. Allocated Transmission Expenses Related to Behind-the-Meter Generation (BTMG) (PFD at p. 167)

The PFD recommends removal of 146 MW of Eastman's BTMG load that SWEPCO added to the Texas jurisdiction for allocation purposes. I ultimately agree with this conclusion because SWEPCO failed to demonstrate that its proposed allocation was reasonable, necessary, and non-discriminatory.

However, this section of the PFD also addresses the reasonableness of SPP transmission service charges in light of federal law and the filed-rate doctrine. Because I would resolve this issue on allocation grounds, I don't see a need for the Commission to make any declarations regarding federal jurisdiction or the filed-rate doctrine. Accordingly, I would remove findings of fact 209 through 212 as well as conclusions of law 34 through 37. To be clear, I am not taking a position on the legal soundness of these findings and conclusions; instead, I recommend their removal because they are not necessary to arrive at the ultimate conclusion regarding jurisdictional allocation of SPP transmission charges.

[5] SWEPCO Initial Brief at 44-48.

7. Texas Cotton Gin Association Class Allocation (PFD at p. 282)

The Texas Cotton Gin Association (TCGA) opposes SWEPCO's class allocation and class cost of service study on the grounds that it inequitably allocates costs to the Cotton Gin rate class. In its exceptions, TCGA asserts that it is distinct from SWEPCO's other commercial classes because it is located in the Panhandle, is not served by underground conduit or primarily from secondary lines, and its vegetation-management requirements are significantly less than SWEPCO's northeast Texas customers. Despite these considerations, TCGA did not present an alternative class allocation or rate design proposal so the ALJs did not make any rate adjustment in response to TCGA's assertions. Moreover, as Commission Staff notes, the allocation of costs based on system wide rates (rather than region-based rates) is consistent with prior Commission precedent.[6] In recognition of this precedent, I would strike finding of fact 251 from the PFD as unnecessary to support the order.

I look forward to discussing these issues with you at the open meeting.

[6] Commission Staff's Reply to Exceptions at 35.